

# MEMORANDUM

March 14, 2001

TO: The Honorable Karen Suter, Commissioner  
The New Jersey Department of Banking and Insurance

FROM: The Prudential Insurance Company of America

RE: The Sale of Shares of Stock of Prudential Financial, Inc. in Connection with the  
Plan of Reorganization of The Prudential Insurance Company of America

This memorandum is submitted to the Commissioner by The Prudential Insurance Company of America ("Prudential" or the "Company") as part of Prudential's application for approval of the Company's Plan of Reorganization dated December 15, 2000 (the "Plan"). The purpose of this memorandum is to demonstrate that the sale of shares of stock of Prudential Financial, Inc. as provided in the Plan complies with the requirements of Section 3.c.(1) of Chapter 17C. Unless otherwise indicated, capitalized terms used in this memorandum have the meanings ascribed to them in the Plan.

## ***Applicable Statutory Provisions***

The governing statutory provision is Section 3.c.(1) of Chapter 17C. It provides in pertinent part that:

*eligible policyholders shall be allocated in the aggregate one hundred per centum (100%) of the common stock of the reorganized insurer or its parent corporation, provided, however, that the commissioner may approve the sale of additional shares of stock of the reorganized insurer or its parent corporation if the mutual insurer demonstrates: (a) a need for additional capital, or (b) that the sale would not significantly dilute the value of the shares distributed to the policyholders.*

Also relevant is Section 3.c.(3), which provides in pertinent part as follows:

*The consideration to be distributed to eligible policyholders shall consist of cash, stock of the reorganized insurer or the parent corporation, or if appropriate for tax or other reasons, additional life insurance or annuity benefits, any combination of these forms of consideration, or other forms of consideration acceptable to the commissioner;... provided, however, that if the consideration to be distributed to one or more classes or categories of eligible policyholders will be in a form other than common stock of a publicly traded company, the plan of reorganization shall include a provision for determining, in a reasonable manner,*

*the value of the consideration by means of reference to (a) the estimated market value of the reorganized insurer...; (b) the per share public market value of the registered common stock of the reorganized insurer or its parent corporation; or (c) by another method acceptable to the commissioner.*

And also relevant is Section 3.c.(4), which provides in pertinent part:

*If the plan of reorganization does not provide for registration and public trading of the common stock of the reorganized insurer or the parent corporation as of the effective date, the plan of reorganization shall require the reorganized insurer or the parent corporation, as applicable, to use good faith efforts, to encourage and assist in the establishment of a market for the common stock of the reorganized insurer or the parent corporation as soon as reasonably possible and in any event not later than two years after the effective date of the reorganization....*

### ***Applicable Plan Provisions***

Article II of the Plan provides that "[t]he Reorganization of the Company pursuant to this Plan will distribute the total value of the Company to all eligible policyholders in the form of shares of Common Stock [of the parent holding company, Prudential Financial, Inc.], cash or Policy Credits upon the extinguishment of all Membership Interests in existence on the Effective Date [of the Plan]".

For purposes of making a distribution of the total value of the Company among eligible policyholders, Article VII of the Plan provides for the allocation (as "Allocable Shares") of 100% of the Common Stock of the Holding Company among Eligible Policyholders. Under Section 8.1 of the Plan, the amount consideration payable to each Eligible Policyholder is "*based on a number of shares of Common Stock equal to the number of notional Allocable Shares that are allocated to such Eligible Policyholder.*" Section 8.1 also governs the forms of consideration, *i.e.*, shares of Common Stock, cash or Policy Credits, that will be received by Eligible Policyholders.

Section 3.2(b)(v) of the Plan requires the sale of shares of Common Stock of the Holding Company in an IPO on the Effective Date of the Reorganization and "Effective Date" is defined in Article I of the Plan as "*the date on which the closing of the IPO occurs....*" Section 7.5 of the Plan provides that the amount of cash and the value of Policy Credits to be distributed to Eligible Policyholders who will receive cash or Policy Credits in respect of their Allocable Shares will be determined by reference to the IPO price.<sup>1</sup>

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<sup>1</sup> Because of the "Top-Up" provision in Section 7.5 of the Plan, the amount of cash and the value of Policy Credits received by Eligible Policyholders for their Allocable Shares could be up to 10% greater than the IPO price based on the performance of the Common Stock in the trading market following the IPO.

Section 3.2(f) of the Plan requires the Company and the Holding Company to "*arrange for the registration and public trading of the Common Stock on a national securities exchange....*"

Section 3.3(c) of the Plan permits the sale by the Holding Company of shares of Class B Stock<sup>2</sup> in a private placement.

### ***Background***

Prudential currently anticipates that the aggregate of the shares of Common Stock distributed to Eligible Policyholders and sold in the IPO will be equal to or less than the total number of Allocable Shares allocated among all Eligible Policyholders.

Prudential Financial, Inc. expects to sell the Class B Stock to institutional investors in a private placement as described in Schedule 3.3(c)(i) to the Plan. It is currently anticipated that less than 2% of the total equity of the Prudential Financial, Inc. will be represented by the Class B Stock after the private placement.

### ***Analysis***

#### **1. The sale of shares allocated but not distributed to Eligible Policyholders will not "significantly dilute" the value of the shares distributed to policyholders.**

The Plan complies with Section 3.c.(1) of Chapter 17C: it allocates 100% of the Common Stock (in the form of Allocable Shares) to Eligible Policyholders. The distribution of these Allocable Shares to some Eligible Policyholders in the form of cash or Policy Credits rather than in the form of shares of Common Stock is consistent with Chapter 17C, which clearly contemplates such a result and expressly permits the value of such non-stock consideration to be determined by reference to the per share public market value of the common stock, as Prudential's Plan requires. Assuming, as is currently intended, that the number of shares of Common Stock sold in the IPO will be equal to or less than the aggregate number of the Allocable Shares attributable to Eligible Policyholders receiving cash and Policy Credits, the shares sold in the IPO will, in effect, represent the Allocable Shares that are allocated but not distributed to the Eligible Policyholders receiving cash and Policy Credits.<sup>3</sup>

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<sup>2</sup> It is contemplated that the Class B Stock of the Holding Company will reflect the economic performance of the Closed Block Business as described in Schedule 3.3(c)(i) to the Plan. It is anticipated that the Class B Stock will rank *pari passu* with the Common Stock in liquidation preference and will vote with the Common Stock as one class; however, the Class B Stock will pay dividends based solely on the results of the Closed Block Business.

<sup>3</sup> We believe there is a substantial question as to whether the sale of these shares in the IPO constitutes a sale of "additional shares" of stock of the reorganized insurer or its parent corporation such as would necessitate the Commissioner's approval under Section 3.c.(1) of Chapter 17C because the shares sold in the IPO, in effect, replace the undistributed Allocable Shares allocated to Eligible Policyholders receiving cash or policy credits.

Thus, the "value of the shares distributed to policyholders" is unaffected if the remaining undistributed Allocable Shares are sold to investors in the IPO instead of being distributed to Eligible Policyholders receiving cash or policy credits. Investors in the IPO, in effect, will simply be replacing those Eligible Policyholders who will receive their consideration in a form other than Common Stock, and the Eligible Policyholders to whom shares of Common Stock are distributed will be in essentially the same position in terms of the value of their ownership interest (as well as in their percentage ownership interest) as they would have been if all the Allocable Shares had been distributed to all the Eligible Policyholders in the form of Common Stock.

In addition, the investors who purchase shares in the IPO will pay market value for their shares.<sup>4</sup> The market price that is established for the Common Stock by the IPO will serve equally as the measure of the value being paid by the investors and the measure of the value being received by those Eligible Policyholders who receive Common Stock. The IPO price (plus the Top-Up, as applicable) will also be the price at which the Eligible Policyholders receiving cash or Policy Credits will, in effect, be selling their stock. The Company believes that the IPO will provide the best independent means available for determining the value of the Allocable Shares.

Irrespective of whether the number of shares of Common Stock sold in the IPO exceed the number of shares allocable to Eligible Policyholders who will ultimately receive cash or Policy Credits, the value of the Common Stock distributed to Eligible Policyholders will not be "significantly diluted" by the sale of shares in the IPO because the Holding Company will receive proceeds from the sale that essentially reflect the perceived market value of these shares. These proceeds will benefit the Holding Company and increase its total shareholders' equity by an amount equal to the net IPO proceeds. Consequently, the economic value of the shares distributed to Eligible Policyholders receiving Common Stock will be substantially the same after the IPO as it would have been immediately prior to the IPO.

## **2. The IPO is likely to enhance the public market value of the shares distributed to Eligible Policyholders.**

As discussed above, Section 3.c.(3) of Chapter 17C expressly provides that the value of non-stock consideration distributed to policyholders may be determined by reference to the "*per share public market value of the registered common stock*" of the reorganized insurer or its parent corporation. Chapter 17C also requires, in Section 8.c.(4), that a plan of reorganization

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<sup>4</sup> Prudential's Plan includes safeguards to ensure that the IPO price will be determined in a way that is fair to policyholders. Section 3.2(g) of the Plan mandates that the Company and the Holding Company must require the managing underwriters for the IPO to conduct the offering process in a manner that is consistent with customary practices for similar offerings. On or prior to the Effective Date for the Plan, the Company must receive an opinion from a qualified, nationally recognized investment banker that this requirement has been complied with in all material respects, and the Company must deliver a copy of that opinion to the Commissioner. Prudential expects the opinion required by this provision of the Plan to be provided by investment bankers who will not be participating in underwriting the IPO. In addition, Section 3.2(g) of the Plan requires that the Commissioner and the Commissioner's financial advisors be given access to the IPO process and the information that leads to the pricing of the Common Stock in the IPO and also requires that the Commissioner find that the terms of IPO promote the best interests of Eligible Policyholders.

must provide for "*registration and public trading of the common stock*" of the reorganized insurer or its parent as of the effective date (or, in the alternative, for good faith efforts to encourage and assist in the establishment of a market for the common stock as soon as reasonably possible thereafter). Prudential believes that the best way to ensure that it will have publicly traded stock for these purposes is to conduct an IPO. An IPO is important in this context because it is an independent offering process that creates a competitive level of interest from knowledgeable investors. It also creates an immediate, liquid market for policyholders who want to buy or sell stock after the demutualization and it establishes an objective price for the stock and an independent competitive market clearing process. Prudential's financial advisors have advised the Company that shares of stocks that are distributed without the benefit of a prior orchestrated institutional offering typically trade poorly over the near term. It is for these reasons that most other demutualizing insurers have provided for, and in a number of cases required, an IPO in their plans of reorganization, and it is for these reasons that Prudential is following the same course. Prudential also believes that these reasons suggest that an IPO is likely to enhance, rather than diminish or "significantly dilute," the value of the shares distributed to policyholders.

**3. The sale of shares of Class B Stock will not "significantly dilute" the value of the shares distributed to policyholders.**

Assuming, as anticipated, that the Class B Stock will represent, at most, less than 2% of the total equity of Prudential Financial, Inc., this sale will not "significantly dilute" the value of the shares distributed to policyholders. Moreover, the reason that the Class B Stock is being sold at the time of the demutualization (as opposed to later) is that Prudential expects this sale to result in an enhancement of, rather than a reduction or dilution in, the value of the Allocable Shares, including the shares distributed to policyholders.

***Conclusion***

For the reasons presented above, the sale of shares of stock as described in the Plan satisfy the requirements of Section 3.c.(1) of Chapter 17C.